

Discussion of “The Choice between Project Finance and Corporate Financing” by Pinto and Alves

Discussion by:
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What is this paper about?

- Examines the pricing of project finance (PF) loans relative to corporate loans.
- Examines the determinants of which firms borrow using project finance.

Hypotheses

- Spread on PF transactions would be lower.
- When issuing relatively large amount of debt, borrowers choose PF over corporate financing.
- Firms with higher information asymmetry prefer PF over corporate financing.
- Risky firms with high agency costs of debt are more likely to chose PF financing.

Pricing of Project Finance Deals

$$WAS_{i,t} = \alpha_0 + \beta \times PF_{i,t} + \gamma \times \text{Contractual characteristics}_{i,t} + \varphi \times \text{Macro factors}_t + \varepsilon_{i,t}$$

Selection issue: Factors that affect PF dummy also affect pricing.

- Counterfactual is unclear.
- The question is what would the spreads be if the issuer had not issued the PF deal.
 - The possibility that unmeasured covariates could be affecting both the choice of deal and its pricing is an important issue in interpreting the spread regressions.

Choice of Debt Regressions

$$\text{Choice of debt}_{i,t} = \alpha_0 + \beta \times \text{Corporate characteristics}_{i,t-1} + \gamma \times \text{Contractual characteristics}_{i,t} + \varphi \times \text{Macro factors}_t + \varepsilon_{i,t} \quad (2)$$

Key Findings - More likely to issue PF:

- Large firms - robust
- More leveraged – not robust
- Tangible assets – mixed evidence
- Less profitable – robust
- Large deals - robust
- Longer maturity - robust
- Switcher - robust

Too many results (21 regressions):

All deals, US, Europe

- PF versus corporate control
- PF versus capital structure
- PF versus fixed asset based
- PF versus general corporate purpose

- All deals – capital intensive
- All deals – utilities
 - Then further four types for utilities

Comments:

- **Unsure about the measures of underinvestment problem and agency costs**
- Many of the results are not consistent with hypotheses.
- Focus on switchers – firms that could have issued both. Then exploit the decision to issue one type of loan versus the other.

Conclusions

- Important area of research – choice of off balance sheet versus on-balance sheet financing
- Project financing is understudied
- Extensive data across many countries – through empirical work
- Interesting results regarding pricing of loans and the decision to use project financing.
- Suggestions:
 - Needs greater focus – smaller samples of firms that could issue both types of loans
 - Empirical design to account for omitted variables